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 Subject: Azurix Strategy

Market Opportunity and Industry Structure

- The world wide opportunity in the Water and Waste Water Industry is tremendous (see excerpts from SG Equity Research on RWE below)

Table 35

**Estimates for infrastructural investment requirements in water**

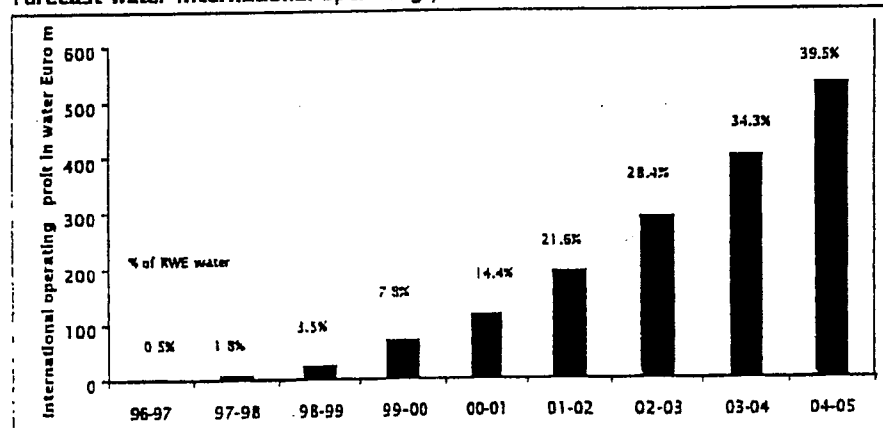
US\$bn	1995-2010e	2000-2015e
Europe	180-220	150
North America	75-90	300
Latin America	50-75	200
Middle East	10-20	50
Asia Pacific	130-145	300
Africa	30-45	100
Total	475-595	1,000

Source: World Bank, Vivendi Environment

"Thames estimates that the private sector water market, currently worth around US\$100bn, will almost quadruple to US \$375bn by 2010." (taken from page 68 of SG Equity Research on RWE)

Figure 40

**Forecast water international operating profit**



Source: Thames, SG Securities estimates

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- o The US market alone is estimated to be significantly large as well.

Region	Investment (\$billion)	Time Frame
US	1,000	2000-2020

Source: American Water Works Association, Water Infrastructure Network (WIN)

- Driving forces behind market opportunity
  - o Population growth and access to water and waste water service
  - o Increasing drinking water quality and environmental standards
  - o Assets predominantly owned by public sector that requires private sector capital and management to address the growing needs
- Challenging market forecast on a year to year basis
  - o Privatization opportunities are driven by local political process
  - o Development of regulatory frameworks takes time
  - o Mergers and acquisitions approval process receive significant political attention and regulatory oversight
  - o Short term disruption of capital markets and access to capital as a result of developing market contagion
    - Tequila effect with Mexico
    - Russia and Turkey economic challenges
    - Argentina current economic situation
- Significant barriers to entry
  - o Cannot bid on privatization opportunities without demonstrated operating and technical capabilities
  - o Mergers and acquisitions candidates want to be acquired by companies that "understand" the water business
  - o Ability to access international capital markets
  - o Experience in privatizing and deregulating markets
- Industry Structure
  - o Industry market leaders are three European Companies
    - Vivendi Environmental
    - Ondeo (Suez)
    - RWE
  - o Opportunities exist to acquire other water and waste companies to gain scale and broaden presence in Europe, American and Far East.
    - Market size and complexity will allow for a new entrant with global capabilities

Market Conclusion

- Tremendous opportunity with the size and complexity of the market
- Market will take time to develop and is difficult to forecast on a quarter-to-quarter and on a year-to-year basis.
- Room for a new market entrant with the qualifications, size, and scale to take advantage of the opportunities

Azurix & Enron Strategy

- Focus on acquisition candidates and concession privatization in markets where Enron and Azurix have in-depth market knowledge
  - Europe, Americas, Far East
- Retain Wessex as a platform to continue to have the world class operating and technical capabilities that are required to participate in the industry
- Develop, using Azurix and Enron personnel, a small cadre of highly experience executives that have experience in project development, evaluation, structuring and operational experience.
- Divest Service Business that have provided limited value and return opportunities in the water industry
  - Azurix North America, IASA Mexico, and Brazil
- Divest Concessions that we do not have direct control over or acquirer is willing to pay more than our reservation price
  - Azurix Cancun and Azurix Mendoza
- Divest high risk projects with significant market and political risk
  - Madera Water Bank, E-Business Initiatives

Strategy Conclusion

- Azurix strategy of focusing on acquisitions and concessions requires a long-term outlook in a slow developing market environment. The initial lack of success was a result of market timing, execution issues and diffusing the focus to include services, water trading operations and E-commerce initiatives. For the next two to three years, Azurix should monitor the developments in the industry and, after that time, be prepared to make select investments.

Economics and Model Development

- Size of the market and dynamic nature of the market requires the development of investment opportunity templates
  - The proforma templates include key assumptions concerning revenue, margins, capital requirement and return on capital potential

- Large Project Assumptions
  - Capital Employed ☐
  - Revenues ☐
  - Margins ☐
  - Debt to Capital Ratio ☐
  - Return on Capital Employed ☐
- Medium Project Assumptions
  - Capital Employed ☐
  - Revenues ☐
  - Margins ☐
  - Debt to Capital Ratio ☐
  - Return on Capital Employed ☐
- Small Project Assumption
  - Capital Employed ☐
  - Revenues ☐
  - Margins ☐
  - Debt to Capital Ratio ☐
  - Return on Capital Employed ☐
- Model Assumptions
  - Number of projects
  - Capital employed
  - Capital Structure / Leverage
  - SG&A
- Economic Conclusion
  - Given the size of the market there is significant opportunity to grow at the forecasted rates without achieving a significant market penetration
  - Return assumptions are achievable based on Azurix actual performance of projects like Cancun
  - See appendix for templates of preliminary macro economic review